

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

APPLIED ELASTOMERICS, INCORPORATED, a
California corporation,

Plaintiff,

v.

Z-MAN FISHING PRODUCTS, INCORPORATED,
a South Carolina corporation,

Defendant.

No. C 06-2469 CW

ORDER GRANTING IN
PART DEFENDANT'S
MOTION FOR LEAVE
TO AMEND ANSWER
AND GRANTING
PLAINTIFF'S
MOTION TO DISMISS
COUNTERCLAIMS

AND RELATED COUNTERCLAIMS.

Defendant Z-Man Fishing Products, Inc. moves for leave to amend its answer to add three additional affirmative defenses and to correct errors made in its original pleading. Plaintiff Applied Elastomerics, Inc. opposes this motion and, in a separate motion, moves to dismiss Defendant's two counterclaims. Defendant opposes Plaintiff's motion in part, limiting the factual predicate of its first counterclaim and agreeing to dismiss its second counterclaim. The matter was heard on March 2, 2006. Having considered all of

1 the papers filed by the parties and oral argument, the Court grants
2 in part Defendant's motion for leave to amend its answer and denies
3 it in part; Plaintiff's motion to dismiss is granted.

4 BACKGROUND

5 As explained in the Court's prior orders, Plaintiff invents
6 and patents certain chemical compositions, composites and articles
7 made from these compositions and composites. Many of its patents
8 concern gel polymers. Plaintiff commercializes its technology by
9 licensing its patents, proprietary technology and know-how to third
10 parties. Plaintiff's president, John Chen, handles all of the
11 business aspects of commercializing the technology he invents and
12 develops. Defendant develops and manufactures fishing lure
13 components and fishing lures for major lure manufacturers. In
14 2001, Mike Shelton, Defendant's Vice President of Marketing and
15 Sales and Director of Technology, contacted Mr. Chen concerning a
16 fishing lure product that he was trying to develop, the
17 "superworm."¹

18 On April 7, 2006, Plaintiff brought this suit for breach of
19 contract and breach of the covenant of good faith and fair dealing.
20 Defendant filed a motion to dismiss for lack of personal
21 jurisdiction, which the Court denied. On July 13, 2006, Defendant
22 filed a complaint against Plaintiff in the District of South
23 Carolina; that case has been transferred to this district.²

24
25 ¹The factual background of this case is described in the
26 Court's August 10, 2006 and November 8, 2006 orders.

27 ²On February 27, 2007, the Court related and consolidated the
28 transferred case, assigned Case No. C. 07-0011, to this case.

1 Defendant filed its answer and twelve counterclaims, alleging
2 (1) breach of the license agreement for failure to provide
3 formulations covered by Plaintiff's patent rights; (2) breach of
4 the license agreement for failure to maintain exclusivity;
5 (3) breach of the covenant of good faith and fair dealing;
6 (4) fraud in the inducement; (5) negligent misrepresentations;
7 (6) fraud in the execution; (7) declaratory judgment of no breach
8 of contract by Defendant, due to lack of consideration resulting
9 from Plaintiff's failure to provide Defendant with a formula within
10 the scope of Plaintiff's patent rights and/or that worked for its
11 intended purpose; (8) declaratory judgment of no breach of contract
12 by Defendant, due to lack of consideration resulting from
13 Plaintiff's failure to maintain exclusivity; (9) declaratory
14 judgment of no breach of contract by Defendant because Defendant's
15 performance under the license agreement is excused by Plaintiff's
16 prior material breach of the license agreement in failing to
17 provide Defendant with a formula within Plaintiff's patent rights
18 and/or that was appropriate for its intended use; (10) declaratory
19 judgment of no breach of contract by Defendant because Defendant's
20 performance under the license agreement is excused by Plaintiff's
21 prior material breach of the license agreement in failing to
22 maintain exclusivity; (11) declaratory judgment of no breach of
23 contract by Defendant for failure to pay royalties because of non-
24 infringement; and (12) restitution for unjust enrichment.

25 Plaintiff moved to dismiss ten of the twelve counterclaims.
26 The Court granted Plaintiff's motion in part, dismissing nine of
27 the counterclaims with leave to amend, including Defendant's
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1 counterclaims for fraudulent and negligent misrepresentation.

2 Defendant then filed its first amended counter-complaint,
3 which contained five causes of action: (1) fraud; (2) negligent
4 misrepresentation; (3) restitution; (4) breach of the covenant of
5 good faith and fair dealing and (5) declaratory relief. With
6 Plaintiff's stipulation, Defendant filed a second amended counter-
7 complaint on January 3, 2007. The second amended counter-complaint
8 contains only two claims for relief: breach of the covenant of good
9 faith and fair dealing and declaratory judgment of no breach of
10 contract for failure to pay royalties because of non-infringement.

11 Plaintiff did not stipulate to allow Defendant to file an
12 amended answer. According to Plaintiff, the affirmative defenses
13 Defendant sought to add were futile. On January 4, 2007, Defendant
14 moved for leave to file its amended answer. The next day,
15 Plaintiff filed its motion to dismiss Defendant's remaining two
16 counterclaims.

17 LEGAL STANDARD

18 I. Motion for Leave to Amend

19 Federal Rule of Civil Procedure 15(a) provides that leave of
20 the court allowing a party to amend its pleading "shall be freely
21 given when justice so requires." Leave to amend lies within the
22 sound discretion of the trial court, which discretion "must be
23 guided by the underlying purpose of Rule 15--to facilitate
24 decisions on the merits rather than on the pleadings or
25 technicalities." United States v. Webb, 655 F.2d 977, 979 (9th
26 Cir. 1981). Thus, Rule 15's policy of favoring amendments to
27 pleadings should be applied with "extreme liberality." Id.; see

1 also DCD Programs, Ltd. v. Leighton, 833 F.2d 183, 186 (9th Cir.
2 1987).

3 Four factors are relevant to whether a motion for leave to
4 amend should be denied: undue delay, bad faith or dilatory motive,
5 futility of amendment, and prejudice to the opposing party. See
6 Foman v. Davis, 371 U.S. 178, 182 (1962). However, these factors
7 are not of equal weight; specifically, delay alone is insufficient
8 ground for denying leave to amend. See Webb, 655 F.2d at 980.
9 Futility of amendment, by contrast, can alone justify the denial of
10 a motion for leave to amend. See Bonin v. Calderon, 59 F.3d 815,
11 845 (9th Cir. 1995). A proposed amendment is futile "if no set of
12 facts can be proved under the amendment to the pleadings that would
13 constitute a valid and sufficient claim or defense." Miller v.
14 Rykoff-Sexton, Inc., 845 F.2d 209, 214 (9th Cir. 1988). In other
15 words, if the proposed amended complaint cannot withstand a motion
16 to dismiss, it should be denied as futile. See id. (citing 3 J.
17 Moore, Moore's Federal Practice § 15.08[4] (2d ed. 1974)).

18 II. Motion to Dismiss

19 A motion to dismiss for failure to state a claim will be
20 denied unless it is "clear that no relief could be granted under
21 any set of facts that could be proved consistent with the
22 allegations." Falkowski v. Imation Corp., 309 F.3d 1123, 1132 (9th
23 Cir. 2002) (citing Swierkiewicz v. Sorema N.A., 534 U.S. 506
24 (2002)). Dismissal of a complaint can be based on either the lack
25 of a cognizable legal theory or the lack of sufficient facts
26 alleged under a cognizable legal theory. Balistreri v. Pacifica
27 Police Dept., 901 F.2d 696, 699 (9th Cir. 1990).

1 All material allegations in the complaint will be taken as
2 true and construed in the light most favorable to the plaintiff.
3 NL Indus., Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir. 1986).

4 A complaint must contain a "short and plain statement of the
5 claim showing that the pleader is entitled to relief." Fed. R.
6 Civ. P. 8(a). "Each averment of a pleading shall be simple,
7 concise, and direct. No technical forms of pleading or motions are
8 required." Fed. R. Civ. P. 8(e). However, "[i]n all averments of
9 fraud or mistake, the circumstances constituting fraud or mistake
10 shall be stated with particularity." Fed. R. Civ. P. 9(b).

11 DISCUSSION

12 I. Defendant's Motion for Leave to Amend

13 Defendant states that its proposed amended answer makes
14 "technical corrections" to its earlier answer, designed to clarify
15 that the parties did not enter into the contract that forms the
16 basis of Plaintiff's complaint, and adds three additional
17 affirmative defenses: fraud, negligent misrepresentation and
18 mistake. Plaintiff challenges only the three affirmative defenses
19 that Defendant seeks to add. According to Plaintiff, all three of
20 these affirmative defenses are futile and, thus, leave to amend
21 should be denied.

22 A. Fraud

23 In order to state an affirmative defense for fraud, Defendant
24 must plead with specificity the following elements:
25 misrepresentation, scienter, intent to defraud, justifiable
26 reliance and resulting damage. See, e.g., Lazar v. Super. Ct., 12
27 Cal. 4th 631, 638 (1996). Defendant claims that it alleges each of
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1 these elements with the requisite detail. According to the
2 proposed amended answer, Mr. Shelton told Mr. Chen that Defendant
3 wanted all of Plaintiff's relevant patents licensed to it
4 exclusively. Mr. Chen told him that the license agreement included
5 all of Plaintiff's patents that would be relevant to the fishing
6 lures. The falsity of this representation was allegedly
7 demonstrated when Mr. Chen later informed Mr. Shelton that the
8 patents covered by the License Agreement included only "the
9 Cadillac of the product" but did not include the "Volkswagen."
10 Defendant alleges that it justifiably relied on Mr. Chen's false
11 statement that the license agreement covered all relevant patents
12 and that it was damaged as a result of Plaintiff's fraudulent
13 assertion.

14 Plaintiff responds that Defendant's affirmative defense
15 closely resembles Defendant's fraudulent inducement counterclaim,
16 which the Court dismissed. The Court previously found that the
17 license agreement is fully integrated and that the agreement
18 explicitly states that the parties have not made any representation
19 or warranties other than those set forth in the agreement. Section
20 10.1 of the agreement provides:

21 EXCEPT AS OTHERWISE EXPRESSLY SET FORTH IN THIS AGREEMENT,
22 NEITHER COMPANY NOR AEI MAKES ANY REPRESENTATIONS OR
23 WARRANTIES OF ANY KIND CONCERNING THE PATENT RIGHTS, EXPRESS
24 OR IMPLIED. . . . Specifically, and not to limit the
25 foregoing, AEI makes no warranty or representation
26 (i) regarding the validity or scope of the Patent Rights,
(ii) that the exploitation of the Patent Rights or any
Licensed Product will not infringe any patents or other
intellectual property rights of AEI or of a third party, and
(iii) that AEI or a third party is not currently infringing
or will not infringe the Patent Rights.

27 License Agreement, § 10.1. Therefore, the Court found that
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1 Defendant's reliance that the patents Plaintiff licensed to it
2 would provide what Defendant needed for its superworm fishing lure
3 was "unjustified as a matter of law" because the agreement
4 contradicts any such representation. November 8, 2006 Order at 12;
5 see also Bank of the West v. Valley Nat'l Bank, 41 F.3d 471, 477
6 (9th Cir. 1994) ("the clear and explicit language of the contract
7 prevented justifiable reliance"). Plaintiff argues that reliance
8 on the purported misrepresentation that the license agreement
9 contained "all" relevant patents similarly is unjustified as a
10 matter of law. It contends that this alleged misrepresentation
11 contradicts the unambiguous statement that Plaintiff made no
12 representation concerning the Patent Rights or the scope of the
13 Patent Rights.

14 As Defendant notes, however, the license agreement, in
15 section 1.7(a), defines "Patent Rights" as "the United States and
16 international patents listed on Schedule A" and "other United
17 States and international patents in which the claims of such
18 patents read on the Licensed Products and are acquired or otherwise
19 owned by AEI during the term of this Agreement in which the Valid
20 Claims of said patents read on the Licensed Product." According to
21 Defendant's proposed amended answer, a purported "Volkswagen"
22 patent was not included in Schedule A and is not part of the Patent
23 Rights. Unlike its prior allegation that Plaintiff misrepresented
24 that its patents would provide what Defendant needed for its
25 superworm fishing lure, Defendant's allegation that Plaintiff
26 misrepresented that it was getting all of Plaintiff's relevant
27 patents does not contradict any unambiguous statement in the
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1 agreement. Therefore, Defendant's reliance is not, as a matter of
2 law, unjustified. Because it would not be futile, the Court grants
3 Defendant leave to amend its answer to add its fraud affirmative
4 defense.

5 B. Negligent Misrepresentation

6 According to the proposed amended answer, Mr. Chen made the
7 following three misrepresentations: (1) that the license agreement
8 included all of Plaintiff's patents that were relevant to the
9 development of the superworm fishing lure; (2) that the sample gels
10 he provided were covered by the Patent Rights reflected in the
11 draft license agreement; and (3) that "subsequent Plaintiff's
12 technology, i.e., material in the form of gel formulation, he
13 forwarded to Defendant was covered by the Patent Rights."

14 Plaintiff argues that, because negligent misrepresentation,
15 like fraudulent misrepresentation, includes justifiable reliance as
16 one of its elements, Defendant's negligent misrepresentation
17 affirmative defense fails for the same reason as its fraudulent
18 misrepresentation affirmative defense. See Walters v. Marler, 83
19 Cal. App. 3d 1, 17 (1978), disapproved on other grounds in Gray v.
20 Don Miller & Associates, Inc., 35 Cal.3d 498 (1984). As discussed
21 above, the Court did not find that Defendant's fraudulent
22 misrepresentation affirmative defense failed as a matter of law.
23 Nor does the Court find that the alleged misrepresentation
24 concerning whether the subsequent technology was covered by the
25 patent rights expressly contradicts any provision in the agreement;
26 however, it is not clear what the reliance is and what the damage
27 to Defendant would be. But the Court does find that the alleged

1 misrepresentation concerning whether the sample gels were covered
2 by the patent rights expressly contradicts the unambiguous
3 provision in the agreement that Plaintiff made no representation
4 concerning the Patent Rights or the scope of the Patent Rights.
5 Therefore, Defendant's reliance upon that alleged misrepresentation
6 is unjustified as a matter of law and Defendant's affirmative
7 defense based on that ground is futile.

8 Claims for negligent misrepresentation must meet the
9 heightened pleading requirement of Rule 9(b). See November 8, 2006
10 Order at 14 (citing Glen Holly Entm't, Inc. v. Tektronix, Inc., 100
11 F. Supp. 2d 1086, 1093 (C.D. Cal. 1999)). Defendant's allegations
12 concerning negligent misrepresentation are not plead with
13 particularity. The first ground on which Defendant bases its
14 negligent misrepresentation defense can be plead with the same
15 facts as its fraud affirmative defense; Defendant may also include
16 its subsequent technology theory as part of its negligent
17 misrepresentation defense if it can do so with particularity.

18 C. Mistake

19 According to the proposed amended answer, in late July, 2001,
20 Plaintiff sent a revised license agreement to Mr. Shelton for his
21 signature. Mr. Shelton signed the document and, on July, 25, 2001,
22 sent it to Mr. Chen with the express understanding and intention
23 that (1) the license agreement provided Defendant with all of
24 Plaintiff's relevant patents and technology that could be used in
25 the fishing lures, (2) the samples that had been provided were
26 covered by Plaintiff's Patent Rights and (3) lower minimum royalty
27 amounts would be agreed upon when customer orders for the product

1 were received. In a transmittal memorandum sent with the signed
2 license agreement, Mr. Shelton attached the sales forecast and
3 royalty numbers and noted that the license agreement covers any and
4 all fishing lures made from Plaintiff's patent formula. Mr.
5 Shelton asked Mr. Chen to advise Defendant if that statement was
6 incorrect.

7 Based on these and additional facts, Defendant contends that
8 the license agreement, so far as it was entered into, must be
9 revised or rescinded due to a mistake.³ Plaintiff responds that
10 Defendant's affirmative defense is not plead with particularity and
11 does not allege a legally cognizable mistake.⁴

12 Federal Rule of Civil Procedure 9 provides, "In all averments
13 of fraud or mistake, the circumstances constituting fraud or
14 mistake shall be stated with particularity." As Moore's Federal
15 Practice explains:

16 In pleading mistake, the circumstances of the error must be
17 set forth with the same high degree of specificity. A good
averment of mistake should include:

- 18 1. the act or writing intended;
- 19 2. the act or writing done;
- 20 3. the cause of the mistake; and
- 21 4. whether the mistake was mutual, unilateral, or merely
that of a scrivener.

22 ³Plaintiff notes that, although Defendant discusses revision
23 and cites the California Civil Code governing when a contract may
be revised, Defendant's affirmative defense itself seeks only
24 rescission. See Defendant's Proposed Amended Answer at ¶ 50.

25 ⁴Plaintiff also argues that Defendant cannot meet the
requirements for rescission under California Civil Code Sections
26 1691 and 1693. Whether Defendant can meet the requirements for
rescission is not at issue in determining whether an amendment is
27 futile; what is at issue is whether the allegations would withstand
a motion to dismiss.

1 Cagan v. Intervest Midwest Real Estate Corp., 774 F. Supp. 1089,
2 1097 (N.D. Ill. 1991) (quoting Moore's Federal Practice ¶ 9.03[1],
3 at 9-26 (2d ed. 1990) (footnote omitted)).

4 Defendant does not dispute that mistake must be plead with
5 particularity; rather, it argues that it has done so. It has not.
6 Therefore, Defendant's motion for leave to amend to include this
7 affirmative defense is denied for failure to plead with the
8 required particularity.

9 Further, based on its non-specific pleading, Defendant does
10 not plead a legally cognizable mistake:

11 California Civil Code § 1689(b) provides for unilateral
12 rescission of a contract "[i]f the consent of the party
13 rescinding . . . was given by mistake." Plaintiffs allege
14 that they were mistaken as to whether the contract required
15 the University to procure royalties, and that this was a
16 mistake of material fact. However, under California law, "[a]
party is bound, even if he misunderstood the terms of a
contract and actually had a different, undisclosed intention."
The fact that plaintiffs were "simply mistaken" in their
belief that the contract contained a royalty requirement does
not serve to release them from their contract.

17 Kucharczyk v. Regents of University of California, 946 F. Supp.
18 1419, 1433 (N.D. Cal. 1996) (inner citations omitted; alterations
19 in original); see also Hedging Concepts, Inc. v. First Alliance
20 Mortgage Co., 41 Cal. App. 4th 1410, 1420-22 (1996) (unilateral,
21 subjective misinterpretation of contract is not a "mistake"
22 constituting grounds for rescission).

23 II. Plaintiff's Motion to Dismiss Counterclaims

24 As noted above, Defendant's second amended counterclaim
25 includes only two causes of action: breach of the covenant of good
26 faith and fair dealing and declaratory relief. Plaintiff moves to
27 dismiss both causes of action.

1 A. First Counterclaim

2 Defendant's first counterclaim alleges that Plaintiff breached
3 the implied covenant of good faith and fair dealing by: (1) failing
4 to conduct its test of infringing products in a reasonable fashion
5 or to maintain exclusivity of its patent; (2) attempting to license
6 other patents to Defendant that it had represented already to be
7 within the license agreement; (3) failing to provide Defendant with
8 Plaintiff's technology that was covered by Plaintiff's Patent
9 Rights; and (4) attempting to extract additional royalty payments
10 not warranted under the license agreement by claiming infringement
11 where none was present and by demanding royalties in excess of the
12 agreed amount. Defendant states that it limits its breach of the
13 covenant claim to its first two theories. Plaintiff responds that,
14 even with this limitation, Defendant's claim fails and should be
15 dismissed without leave to amend.

16 The implied covenant of good faith and fair dealing
17 supplements "the express contractual covenants, to prevent a
18 contracting party from engaging in conduct that frustrates the
19 other party's rights to the benefits of the agreement." Waller v.
20 Truck Ins. Exchange, Inc., 11 Cal. 4th 1, 36 (1995). The
21 California Supreme Court explains, "Absent that contractual right,
22 however, the implied covenant has nothing upon which to act as a
23 supplement, and 'should not be endowed with an existence
24 independent of its contractual underpinnings.'" Id. (quoting Love
25 v. Fire Ins. Exchange, 221 Cal. App. 3d 1136, 1153 (1990)); see
26 also Guz v. Bechtel Nat. Inc., 24 Cal. 4th 317, 349-50 (2000) (the
27 implied covenant of good faith and fair dealing "cannot impose

1 substantive duties or limits on the contracting parties beyond
2 those incorporated in the specific terms of their agreement").
3 Indeed, "courts are not at liberty to imply a covenant directly at
4 odds with a contract's express grant of discretionary power except
5 in those relatively rare instances when reading the provision
6 literally would, contrary to the parties' clear intention, result
7 in an unenforceable, illusory agreement." Third Story Music, Inc.
8 v. Waits, 41 Cal. App. 4th 798, 808 (1995).

9 For an implied covenant to be imposed, "'(1) the implication
10 must arise from the language used or it must be indispensable to
11 effectuate the intention of the parties; (2) it must appear from
12 the language used that it was so clearly within the contemplation
13 of the parties that they deemed it unnecessary to express it;
14 (3) implied covenants can only be justified on the grounds of legal
15 necessity; (4) a promise can be implied only where it can be
16 rightfully assumed that it would have been made if attention had
17 been called to it; (5) there can be no implied covenant where the
18 subject is completely covered by the contract.'" Id. at 804
19 (quoting Lippman v. Sears, Roebuck & Co., 44 Cal.2d 136, 142
20 (1955)).

21 1. Exclusivity

22 The agreement provides that Defendant "shall have the right,
23 under its own control and at its own expense, to prosecute any
24 third party infringement of the Patent Rights " License
25 Agreement, § 7.2. It also provides that Plaintiff "shall have the
26 right, at its sole discretion, to prosecute such infringement, or
27 answer such declaratory judgment action, under its sole control and
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1 at its sole expense. . . ." License Agreement, § 7.5.

2 Defendant acknowledges that, under the agreement, Plaintiff is
3 not required to maintain the exclusivity of the licensed patents
4 and, therefore, Plaintiff was not required to undertake any testing
5 on potentially infringing products. See November 8, 2006 Order at
6 11. It states that it is not arguing that Plaintiff breached the
7 covenant of good faith and fair dealing by failing to maintain
8 exclusivity of the licensed patents, but rather that Plaintiff
9 engaged in conduct that interfered with Defendant's right to enjoy
10 the exclusivity of the licensed patents. According to the second
11 amended counter-complaint, Defendant notified Plaintiff of
12 potential infringement of the patents; Plaintiff stated that it
13 would take care of it, but then unreasonably delayed the testing it
14 said it would undertake. Had Plaintiff not promised to "take care
15 of it," Defendant contends that it would have not have waited for
16 Plaintiff to conduct the testing. Nonetheless, because the
17 agreement did not require Plaintiff to test the potentially
18 infringing products but rather gave it discretion to do so, the
19 covenant of good faith and fair dealing cannot impose on Plaintiff
20 the obligation of testing the products in a reasonable manner.
21 Defendant identifies no other conduct by Plaintiff that allegedly
22 interfered with its right to enjoy the exclusivity of the licensed
23 patents. Therefore, to the extent that Defendant's claim for
24 breach of implied covenant of good faith and fair dealing is based
25 on these grounds it is dismissed. Defendant does not proffer any
26 amendment that would remedy the deficiency of its claim, but, in an
27 abundance of caution, the Court once again grants it leave to amend
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1 to attempt to do so.

2 2. Additional Patents

3 As discussed above, Defendant alleges that, although Plaintiff
4 stated that the license agreement covered all patents relevant to
5 the superworm fishing lure, Plaintiff later informed Defendant that
6 it had licensed only the "Cadillac of the product" and not the
7 "Volkswagen." Plaintiff sought an additional \$10,000 to license
8 additional patents. Defendant does not make clear which patent is
9 the "Volkswagen."

10 In its opposition, Defendant states that its allegation that
11 Plaintiff attempted to license patents to Defendant that Plaintiff
12 represented already to be within the license agreement is the basis
13 of its affirmative defenses, and that its counterclaim for breach
14 of the implied covenant of good faith and fair dealing is based on
15 its allegation that, if Plaintiff did license all of its pertinent
16 patents to Defendant, Plaintiff's insistence on a \$10,000 payment
17 to add the "Volkswagen" patent interfered with Defendant's right to
18 the exclusivity of all of the patents that Plaintiff contends that
19 it licensed to Defendant.

20 Plaintiff responds that this theory fails because it is based
21 on facts not included in the counter-complaint, contradicts the
22 factual allegations in the counter-complaint and negates
23 Defendant's fraud affirmative defense.⁵ Defendant alleges in its
24 counter-complaint that Plaintiff has represented that additional
25 patents, the "Non-Fishing Lure Patents," were included in the

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27 ⁵As the Court found in its prior order, "Defendant may plead
alternative theories." November 8, 2006 Order at 16.

1 license agreement. Second Amended Counter-Complaint, ¶ 30.
2 Nonetheless, Defendant does not allege that any of the Non-Fishing
3 Lure Patents is the "Volkswagen" patent. For purposes of a Rule
4 12(b)(6) motion, "review is limited to the contents of the
5 complaint." Clegg v. Cult Awareness Network, 18 F.3d 752, 754 (9th
6 Cir. 1994). Defendant's argument that it states a claim for breach
7 of implied covenant of good faith and fair dealing is based on
8 allegations not included in its counter-complaint. For this
9 reason, the Court dismisses this claim. Defendant is granted to
10 leave to amend its counter-complaint to include these allegations
11 if it can do so truthfully. The Court dismisses with prejudice
12 Defendant's breach of the covenant claim to the extent it is based
13 on an allegation that Plaintiff attempted to license patents to
14 Defendant that Plaintiff had represented already to be within the
15 license agreement, a theory Defendant has abandoned.

16 B. Second Counterclaim

17 Defendant's second counterclaim seeks declaratory relief.
18 Defendant agrees to the dismissal of this claim. Nonetheless, it
19 addresses at length whether a contract was formed and, if so, what
20 it entailed. Plaintiff responds, requesting that the Court treat
21 its motion to dismiss the declaratory judgment claim as a motion
22 for judgment on the pleadings and decide the underlying issues of
23 contract formation and the applicable minimum royalty schedule.
24 The Court will not do so. Defendants' second counterclaim for
25 declaratory relief is dismissed with prejudice.

26 CONCLUSION

27 For the foregoing reasons, Defendant's Motion for Leave to
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1 File an Amended Answer (Docket No. 76) is GRANTED IN PART and
2 DENIED IN PART. The Court grants Defendant leave to amend its
3 answer to correct errors made in its original pleading and to
4 include its affirmative defense of fraud. But the Court denies
5 Defendant leave to amend its answer to include an affirmative
6 defense based on the alleged misrepresentation that the sample gels
7 were covered by the patent rights. Defendant may amend its
8 negligent misrepresentation affirmative defense to allege the same
9 facts that support its fraud affirmative defense and may try to
10 amend its negligent misrepresentation affirmative defense
11 concerning subsequent technology and its mistake affirmative
12 defense, but only if it can do so with particularity and within the
13 bounds of Rule 11. Plaintiff's Motion to Dismiss Counterclaims
14 (Docket No. 78) is GRANTED. Defendant is granted leave to amend
15 its first counterclaim consistent with this order; its second
16 counterclaim, however, is dismissed without leave to amend.
17 Defendant must submit its third amended counterclaims and its
18 amended answer within ten days from the date of this order. As
19 discussed at the hearing, Defendant shall include in this pleading
20 any viable claims it wishes to pursue from the transferred South
21 Carolina action.

22 IT IS SO ORDERED.

23
24 Dated: 3/5/07



CLAUDIA WILKEN
United States District Judge